

Chapter 7

VALUE-ADDED TAX BASE

The projected 1988 level of total personal consumption expenditure is about \$3,100 billion; therefore, each percentage point of a value-added tax levied on this total would yield about \$31 billion. In fact, as explained in Chapter 6, a realistic value-added tax base would be well below this, because of the difficulty or inadvisability of taxing certain items of consumer expenditure. Drawing on the recommendations in Chapter 6, this chapter describes some alternative value-added tax bases.

The rental value of owner- and tenant-occupied housing constitutes about one-sixth of total 1988 personal consumption expenditure. In the case of owner-occupied housing, the rental figure is an imputed amount or a measure of what the housing would rent for on the open market. Since it would not be practical to apply a value-added tax to this amount, the rent on tenant-occupied housing would not be subject to a value-added tax either. As shown in Table 7-1, exempting the rental value of all housing would remove \$460 billion from the 1988 base. Since housing rents would be exempt, rather than zero rated, no credit would be allowed for value-added tax paid on expenditures for repair and maintenance. Applying the value-added tax to sales of new housing, plus repairs and alterations would add \$170 billion to the tax base, since these items are not reflected in the total of personal consumption expenditure.

A number of other items of personal consumption expenditures would also be at least partially excluded for a variety of reasons. For these categories, recall the important distinction between exemption and zero rating. With exemption, no value-added tax would apply to the sale of the exempt good or service, but no credit would be allowed for tax paid on items that were purchased to produce or provide the exempt good or service. An exempt good or service, therefore, bears some value-added tax, namely the tax on the purchased inputs used to produce it. Zero rating, on the other hand, totally frees a good or service from value-added tax. No tax applies on the sale, and a full credit or refund is allowed for tax paid on purchased inputs.

Additional exclusions from personal consumption expenditure to arrive at the comprehensive base include the services of physicians, dentists, and other health professionals, which would be exempt and hospitals, education, and religious and welfare activities, which would be zero rated. As noted in Chapter 6, this treatment is necessitated by a combination of social and distributional considerations.

Table 7-1

ESTIMATE OF VALUE-ADDED TAX BASE

(\$ Billions)

1988 Levels of Expenditures

Total Personal Consumption Expenditures		\$3,127
Less: Rental value of owner- and tenant- occupied housing (including farms)	460	
Medical care (including health insurance)	232	
Insurance and finance (other than health insurance)	74	
Education	48	
Religious and welfare	47	
Foreign travel	13	
Local transportation	8	
Other: Food produced and consumed on farms, military-issued clothing, domestic services)	<u>7</u>	
		- 889
Plus: Sales of new housing		<u>170</u>
Comprehensive Value-Added Tax Base		<u>\$2,408</u>

Primarily because of the administrative difficulty of measuring value added, banking and insurance would be exempt, except for those activities for which there is an explicit charge, such as the rental of safe deposit boxes. Expenditures for foreign travel also would be excluded from the base (zero rated) for administrative reasons. (Expenditures by foreigners traveling in the United States would generally be subject to tax.) Both local transit service and commuter rail transport, which are frequently subsidized, would be zero rated to encourage their use. Taxi service, on the other hand, would be exempt for administrative reasons. All of the exclusions which are used to arrive at the comprehensive value-added tax base of \$2,408 billion (at 1988 levels of expenditure) or 77 percent of total consumption are listed in Table 7-1.

It would be preferable not to exclude food consumed at home from the base, if an alternative for lessening the burden of the tax on the poor were available. If, however, it is decided to exclude food, zero rating of food would reduce the base by an additional \$349 billion to \$2,059 billion or 66 percent of total consumption. Zero rating of sales of new housing, prescription drugs, and household energy expenditures for electricity, gas, fuel oil, and water and sanitation services would reduce the base further to \$1,713 billion or 55 percent of total consumption.